



From the perspective of KCP&L and GMO, Staff's recommended approach is wholly inadequate as it ignores fundamental changes to the electric utility operating environment that have occurred over the past decade or so and which are not expected to reverse course. For example, Staff agrees that load growth, which has historically been positive for Missouri's electric utilities, has largely disappeared and been replaced with declining customer usage.<sup>3</sup> Staff also states that customers could realize benefits from the deployment of advanced distribution system technology by Missouri's electric utilities at a speedier rate than is occurring today.<sup>4</sup> Nor does Staff dispute the fact that during the 2006-2015 time period when it operated under a proactive capital expenditure philosophy – with a capital expenditure to depreciation expense ratio of 2.8 for that period<sup>5</sup> - KCP&L's achieved Missouri jurisdictional earnings fell short of its Commission-authorized earnings level by more than \$34 million per year, on average, despite the fact that KCP&L filed and completed six general rate proceedings during that 10-year period.<sup>6</sup> Inexplicably, however, Staff concludes that no meaningful legislative changes are warranted by these facts.

Absent a reasonable opportunity to achieve Commission-authorized earnings levels, KCP&L and GMO cannot simultaneously honor the fiduciary obligation owed to shareholders and deploy a proactive capital expenditure philosophy. KCP&L adopted a proactive capital expenditure philosophy in carrying out the Comprehensive Energy Plan approved by the Commission in Case No. EO-2005-0329 and a similar philosophy would be necessary to deploy advanced distribution system technology, replace aging infrastructure at a pace faster than has occurred in recent years or otherwise deploy capital beyond what is necessary to maintain the

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<sup>3</sup> See *id.* at 32.

<sup>4</sup> See *id.* at 50.

<sup>5</sup> See "Is there a problem that needs to be addressed?" EFIS Item No. 50, Slide 3.

<sup>6</sup> Staff Report at 3.

provision of safe and adequate service. Such a proactive capital expenditure philosophy would require the devotion of considerable planning, engineering, design, procurement and construction efforts over many years. Not surprisingly, deployment of such a proactive capital expenditure philosophy would require the hiring of additional employees to perform that additional work. Given the level of effort and commitment required to deploy such a proactive capital expenditure philosophy, effective and efficient implementation of such an approach requires consistent and steady effort that is sustained over multiple years.

Exclusive reliance on the discretion of the Commission to adopt and sustain a regulatory construct that would allow an electric utility to simultaneously honor the fiduciary obligation owed to shareholders while deploying a proactive capital expenditure philosophy has been shown by history to be problematic. Commissioners typically desire the ability to judge each rate proceeding and regulatory request based on the facts prevailing at the time and, consequently, are reluctant to take action which is binding on a future commission. Although perhaps understandable when viewed from the perspective of the Commission as an institution, this approach will not foster the deployment of a proactive capital expenditure philosophy by electric utilities because it will not produce a regulatory construct that can be relied upon with a sufficient degree of certainty.

As an example, the Commission promulgated revised gas safety rules in the late 1980's that required significant facility replacements by certain natural gas local distribution companies ("LDCs") in Missouri. In recognition of the financial impact of the required facility replacements, the Commission routinely issued accounting authority orders ("AAOs") to LDCs permitting the deferral of depreciation expense, carrying costs, and property taxes in connection with facilities replacements required by the new gas safety rules. See Case Nos. GO-90-51

(Kansas Power & Light Company – “KPL”, subsequently became MGE); GO-90-115 (Missouri Public Service – “MPS”); GO-90-215 – United Cities Gas – “UCG”); GO-91-359 – MPS; GO-92-67 – UCG; GO-92-185 (KPL, subsequently became Missouri Gas Energy – “MGE”); GO-94-133 (Western Resources, Inc., f/k/a KPL, subsequently became MGE); GR-94-220 (Laclede Gas); GO-94-234 (MGE); GR-96-193 (Laclede Gas); GO-97-301 (MGE); GR-98-140 (MGE); GR-99-315 (Laclede Gas); GR-01-292 (MGE). Initially, the gas safety AAOs authorized the deferral of carrying costs at the affected LDC’s authorized rate of return. See e.g., Case Nos. GO-94-133 and GO-94-234.

After a number of years, however, certain parties began to challenge the Commission’s routine issuance of gas safety AAOs as well as the carrying cost rate to be included in revenue requirement and rates, and the Commission reduced the gas safety AAOs carrying cost rate that could be included in rates from the authorized rate of return to a rate based on the allowance for funds used during construction. This reduction in the carrying cost rate applicable to gas safety AAOs was challenged, but upheld on appeal. Missouri Gas Energy v. Pub. Serv. Comm’n, 978 S.W.2d 434 (Mo.App. W.D. 1998). Because the gas safety rules required ongoing facilities replacements (continuing to this day for some of Missouri’s LDCs), this situation became untenable for the LDCs and ultimately led to the introduction and passage of the infrastructure system replacement surcharge (“ISRS”) legislation applicable to LDCs (Sections 393.1009-1015).

Like the gas ISRS legislation, a regulatory construct that is codified into law could be relied upon by Missouri’s electric utilities and the customers they serve in a way that has simply been unachievable through the Commission’s exercise of regulatory discretion. Absent legislation that provides a regulatory construct that allows an electric utility to simultaneously

honor the fiduciary obligation owed to shareholders while deploying a proactive capital expenditure philosophy, KCP&L and GMO cannot operate under a proactive capital expenditure philosophy that would enable the deployment of advanced distribution system technology, speedier replacement of aging infrastructure or otherwise deploy capital beyond what is necessary to maintain the provision of safe and adequate service.

WHEREFORE, KCP&L and GMO offer this response to the Staff's Report.

Respectfully submitted,

*/s/ Robert J. Hack*

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### **CERTIFICATE OF SERVICE**

I do hereby certify that a true and correct copy of the foregoing document has been hand delivered, emailed or mailed, postage prepaid this 10<sup>th</sup> day of November, 2016, to all parties of record.

*/s/ Robert J. Hack*

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Robert J. Hack